

O. IRC 4945 - DECENTRALIZATION OF ADVANCE APPROVAL OF GRANT-MAKING PROGRAMS UNDER IRC 4945(g)

1. Introduction

Section 5.03 of Rev. Proc. 83-36, 1983-1 C.B. 763, provides that a key District Director will now make determinations of exempt status in cases where an organization has a grant-making program requiring advance approval under IRC 4945(g). If an organization requests advance approval of its grant-making procedures under IRC 4945(g), the key District Director will, with certain exceptions, make a determination on that issue also. If questions arise regarding grant-making procedures that cannot be resolved on the basis of law, regulations, or a clearly applicable revenue ruling or other published precedent, technical advice on the matter must be requested of the National Office.

IRM 7666.3 and IRM 7(10)66.5 also reflect this decentralization of IRC 4945(g) approval. They provide that, subject to mandatory technical advice in certain instances, determinations will be made in key districts where a private foundation's grant-making program requires advance approval under IRC 4945(g), either as part of an exemption application or in a separate approval request.

The purpose of this article is to provide a general overview of the statutory and regulatory provisions that are applicable in determining whether an organization's grant-making program satisfies the requirements of IRC 4945(g). This is not intended to be a complete restatement of this subject. Rather, it is intended to serve as a general guide for processing IRC 4945(g) requests, since Chapter (17)00 of IRM 7752, Private Foundations Handbook, and articles in prior Exempt Organizations Annual Technical Review Institute (ATRI) or Continuing Professional Education (CPE) volumes have already considered this area in depth. When appropriate, reference will be made to these sources. In addition, this article will point out issues which should be referred to the National Office for consideration.

2. The Threshold Question - Is IRC 4945(d)(3) Applicable?

IRC 4945(d)(3) provides that the term "taxable expenditure" means any amount paid or incurred by a private foundation as a grant to an individual for travel, study, or similar purposes by such individual, unless the grant satisfies the

requirements of IRC 4945(g). See pages 161-162 of the 1980 ATRI for a discussion of the legislative history of IRC 4945(d)(3).

Therefore, IRC 4945(d)(3) is applicable only if the following factors are present:

- (1) the payment in question is a grant,
- (2) the grant is to an individual, and
- (3) the grant is made for travel, study, or other similar purposes by such individual.

The term "grants" is defined in Reg. 53.4945-4(a)(2) to include scholarships, fellowships, internships, prizes, and awards. A scholarship, fellowship, or internship is an amount paid to aid in the pursuit of the recipient's studies, whereas prizes and awards are generally made in recognition of some past accomplishment of the recipient. The term "grants" also includes loans for charitable or educational purposes. However, the term "grants" does not ordinarily include salaries or other compensation to employees, such as educational payments which are includible in the employees' incomes pursuant to IRC 61. In addition, "grants" would not ordinarily include payments to persons for personal services such as assisting a foundation in planning, evaluating, or developing its projects.

If a private foundation makes a grant to another organization, with the understanding that the grantee organization will in turn award grants to individuals for educational purposes, the nature of the initial grantee organization and the extent of the grantor foundation's control over the selection of the ultimate individual grantee will determine whether the grant is to an individual and within the scope of IRC 4945(d)(3). See Reg. 53.4945-4(a)(4). See also pages 163-165 of the 1980 ATRI.

To fall within the scope of IRC 4945(d)(3) a grant must be for travel, study, or other similar purposes. Therefore, an award made in recognition of an individual's past literary, artistic, scientific, or similar achievements would not be subject to IRC 4945(d)(3) if there are no conditions or requirements to be met by the recipient subsequent to receiving the award. However, such an award may still constitute a "taxable expenditure" if it is not made for a charitable purpose within the scope of IRC 170(c)(2)(B). See IRC 4945(d)(5). See also pages 165-169 of the 1980 ATRI for a discussion of revenue rulings that address this question.

3. IRC 4945(g) - The Exception to IRC 4945(d)(3)

IRC 4945(g) provides that IRC 4945(d)(3) shall not apply to an individual grant awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance by the Secretary, if it is demonstrated that:

- (1) the grant constitutes a scholarship or fellowship grant which is subject to the provisions of IRC 117(a) and is to be used for study at an educational organization described in IRC 170(b)(1)(A)(ii),
- (2) the grant constitutes a prize or award which is subject to the provisions of IRC 74(b), if the recipient of such prize or award is selected from the general public, or
- (3) the purpose of the grant is to achieve a specific objective, produce a report or similar product, or improve or enhance a literary, artistic, musical, scientific, teaching, or other similar capacity, skill, or talent of the grantee.

4. Requirement of Advance Approval

To satisfy IRC 4945(g), a private foundation must have its grant-making program approved in advance. Therefore, any grant awarded prior to receiving approval will constitute a "taxable expenditure" even if the program meets all the other requirements of IRC 4945(g). The approval procedure is contemplated as a one-time approval of the foundation's program, and such approval will apply to all subsequent grants so long as there is no material change in the approved program. See Reg. 53.4945-4(d)(1).

In general, the advance approval requirement is applicable with respect to all grants made after January 28, 1973. See Reg. 53.4945-4(e)(1). In addition, the following transitional rules are applicable:

- (i) Grants made pursuant to a commitment in effect prior to January 1, 1970 are not subject to IRC 4945(d)(3) if such commitment was made in accordance with the foundation's usual practices and was reasonable in amount. See Reg. 53.4945-4(e)(2)(i).

- (ii) Grants awarded from January 1, 1970 through January 28, 1973, and paid within 48 months after the award will generally be deemed to satisfy the requirements of IRC 4945(g). See Reg. 53.4945-4(e)(2)(ii).

5. The 45-Day Rule

If a foundation properly submits a request for approval of grant procedures and is not notified by the Service within 45 days that such procedures are not acceptable, then such procedures shall be considered as approved from the date of submission until receipt of actual notice that such procedures are not acceptable. See Reg. 53.4945-4(d)(3). See also pages 183-187 of the 1982 CPE.

6. Requirements of a Proper Procedure

In order to receive advance approval of its grant-making procedures, a foundation must demonstrate that:

- (i) its grant procedures include an objective and nondiscriminatory selection process,
- (ii) such procedures are reasonably calculated to result in performance by grantees of the activities that the grants are intended to finance, and
- (iii) the foundation plans to obtain reports to determine whether the grantees have performed the activities that the grants are intended to finance.

Procedures may vary depending upon such factors as the size of the foundation, the amount and purpose of the grants, and whether one or more recipients are involved. See Reg. 53.4945-4(c)(1).

In order for a foundation to establish that its grants to individuals are made on an objective and nondiscriminatory basis, certain regulatory criteria must be satisfied. Reg. 53.4945-4(b)(1) requires that the grants be awarded in accordance with a program which is consistent with the foundation's exempt status under IRC 501(c)(3) and also satisfy three requirements relating to eligibility and the selection process. First, the group from which the grantee is selected must ordinarily be large enough to constitute a charitable class, unless the grant is intended for a particular

purpose for which there is only a small number of qualified persons, such as a scientific research project. See Reg. 53.4945-4(b)(2). Secondly, the criteria used in selecting grant recipients should be related to the purpose of the grant. For example, proper criteria for selecting scholarship recipients might include (but are not limited to) the following: prior academic performance; performance on aptitude tests; recommendations from instructors; and the conclusions which the selection committee might draw from a personal interview as to the individual's motivation, character, ability and potential. See Reg. 53.4945-4(b)(3). Finally, the person or group of persons who select grant recipients should not be in a position to derive a private benefit, directly or indirectly, if certain potential grantees are selected over others. See Reg. 53.4945-4(b)(4).

The other procedural requirements under IRC 4945(g) are intended to ensure that the foundation's grants are used for their intended purposes. The foundation's procedures must include a follow-up mechanism to review the use of the grant and investigate any misuse of funds. Special rules apply to scholarship and fellowship grants. If the award is made directly to the student, the foundation must receive a report of his/her courses and grades from the educational institution at least once a year. If the individual is not attending school, a yearly progress report must be obtained. See Reg. 53.4945-4(c)(2). However, when a scholarship grant is paid directly to an educational institution that agrees to supervise the use of the grant, the foundation is not required to adopt follow-up mechanisms. See Reg. 53.4945-4(c)(5). In the case of grants described in IRC 4945(g)(3), the foundation must obtain progress reports at least once a year, along with a final report upon completion of the undertaking for which the grant was made. See Reg. 53.4945-4(c)(3). Where the required reports or other information (including the failure to submit the required reports) indicates that all or any part of the grant is being used for improper purposes, the foundation is under a duty to investigate such misuse and withhold further payments to the extent possible while conducting its investigation. In cases where grant funds have actually been used improperly, the foundation will not generally be treated as having made a taxable expenditure so long as it takes all reasonable and appropriate steps to recover the diverted funds and takes necessary precautions to prevent future diversions. See Reg. 53.4945-4(c)(4).

7. Requirement that Grants be Described in IRC 4945(g)(1), (2), or (3)

a. Scholarship and Fellowship Grants - IRC 4945(g)(1)

The first category of grants acceptable under IRC 4945(d)(3) are scholarships or fellowship grants that are subject to the provisions of IRC 117(a), and are to be used for study at an educational organization described in IRC 170(b)(1)(A)(ii).

Most educational grant programs are "community based," in that any limitation on eligibility to participate in the grant program is based on residency in a particular geographic locale or community, or attendance at a particular school. However, a number of special rules have been developed with respect to employer-related grant programs. An employer-related program is a program that treats some or all of the employees, or children of some or all of the employees, of a particular employer as a group from which grantees of some or all of the foundation's educational grants will be selected. Guidelines for determining whether grants made under an employer-related program constitute scholarships or fellowships under IRC 117 are set forth in Rev. Proc. 76-47, 1976-2 C.B. 670. These guidelines are intended to ensure that scholarships are awarded primarily to further the recipient's education rather than to compensate company employees. Rev. Proc. 80-39, 1980-2 C.B. 772, sets forth guidelines for determining whether educational loans made under an employer-related loan program are taxable expenditures. Those revenue procedures were reproduced and discussed on pages 189-204 of the 1982 CPE. In addition, certain factual situations and problems relating to employer-related grant programs were discussed on pages 156-163 of the 1983 CPE. Although Rev. Proc. 76-47 and Rev. Proc. 80-39 make specific reference to employees and children of employees, other business relationships (such as newspaper boys, franchise holders, etc.) and other family relationships (such as grandchildren, spouses, etc.) would be analogous to employees and children of employees, respectively. Rev. Proc. 81-65, 1981-2 C.B. 690, clarifies Rev. Proc. 76-47 and Rev. Proc. 80-39 with regard to publicizing an employer-related grant or loan program in the employer's company newsletter.

b. Prizes and Awards - IRC 4945(g)(2)

The second category of grants acceptable under IRC 4945(d)(3) are prizes or awards that are subject to the provisions of IRC 74(b). The recipient of such prize or award must be selected from the general public. IRC 74(b) provides that gross income does not include amounts received as prizes and awards made primarily in recognition of religious, charitable, scientific, educational, artistic, literary, or civic achievement, but only if the recipient was selected without any action on his/her part to enter the contest or proceeding, and the recipient is not required to render substantial future services as a condition to receiving the prize or award. See Rev.

Rul. 77-380, 1977-2 C.B. 419, which is reproduced on pages 166-168 of the 1980 ATRI.

c. Grants to Achieve a Specific Objective - IRC 4945(g)(3)

The third category of grants acceptable under IRC 4945(d)(3) are grants to achieve a specific objective, produce a report or similar product, or improve or enhance a literary, artistic, musical, scientific, teaching, or other similar capacity, skill, or talent of the grantee. It should be noted that a grant described in IRC 4945(g)(3) that otherwise meets the requirements of IRC 4945(g) shall not be treated as a taxable expenditure, even if it is a scholarship or fellowship grant which is not excludable from income under IRC 117 or a prize or award which is includible in income under IRC 74. See Reg. 53.4945-4(a)(3)(ii). See also pages 182-187 of the 1980 ATRI for a discussion of revenue rulings pertaining to IRC 4945(g)(3).

8. Processing Exemption Applications Involving IRC 4945(g)

The presence of a grant-making program needing advance approval under IRC 4945(g) would generally be indicated in one or more of the following locations on Form 1023:

- (i) Part I - Activity codes 039, 040, or 041
- (ii) Part III - Grants, scholarships, or loans to individuals listed as an activity or benefit
- (iii) Part V - Financial data on line 9 shows grants were made directly or indirectly (through another entity) to individuals
- (iv) Part VI - Indication that Schedule B is required
- (v) Schedule B - Schedule for "Organizations Providing Scholarship Benefits, Student Aid, etc. to Individuals"

In addition, the organizational document or operating bylaws may reveal that grants to individuals are contemplated.

When IRC 4945(g) approval is requested (normally on Schedule B) or appears necessary, it should first be determined that the organization in question is actually a private foundation as defined in IRC 509. If it is determined that the organization is not a private foundation, IRC 4945 is not applicable. In the event that the organization qualifies for exemption as a public charity, the determination letter should include the following warning:

Rev. Rul. 56-304, 1956-2 C.B. 306, holds that an organization exempt under section 501(c)(3) of the Code may, consistent with its exempt status, distribute funds to individuals, provided it keeps adequate records. These records should show the name and address of each recipient, the reason that person was selected, the method of selection, and the family or business relationship, if any, to people connected with the organization making the gift.

Once it is concluded that the organization is a private foundation, it should be ascertained that IRC 4945(d)(3) is applicable by answering the following questions:

1. Will the payments constitute grants? See Reg. 53.4945-4(a)(2).
2. Are the grants made to individuals? See Reg. 53.4945-4(a)(4).
3. Are the grants for travel, study, or other similar purposes?

If any of these questions is answered in the negative, IRC 4945(d)(3) and IRC 4945(g) are not applicable. See section 2 of this article.

Next, it must be determined whether the grants are described in IRC 4945(g)(1), (2), or (3) by ascertaining the type of grant provided:

1. Scholarship or fellowship grant. See Reg. 53.4945-4(a)(3)(ii)(c)(1).
2. Prize or award. See Reg. 53.4945-4(a)(3)(ii)(c)(2).
3. Grant to achieve a specific objective. See Reg. 53.4945-4(a)(3)(ii)(c)(3).

See also section 7 of this article.

It must then be determined whether the organization's grant-making procedures are proper. See Reg. 53.4945-4(c) and section 6 of this article. In this regard, the following questions should be considered:

1. Is the grant intended to accomplish an IRC 501(c)(3) purpose? See Reg. 53.4945-4(b)(1)(i).
2. Is the grant consistent with the allowance of deductions to individuals under IRC 170 for contributions to the granting foundation? See Reg. 53.4945-4(b)(1)(ii).
3. Is the group from which grant recipients are selected sufficiently broad so that the making of grants to members of the group will fulfill a charitable purpose? See Reg. 53.4945-4(b)(2).
4. Are the criteria used in selecting grant recipients related to the purposes of the grant? See Reg. 53.4945-4(b)(3).
5. Is the person or group of persons who select recipients of the grants sufficiently independent so as not to be in a position to derive a private benefit, either directly or indirectly, if certain potential grantees are selected over others? See Reg. 53.4945-4(b)(4).
6. Are the foundation's procedures reasonably calculated to result in the performance by grantees of the activities that the grants are intended to finance? See Reg. 53.4945-4(c)(1)(ii).
7. Does the foundation plan to obtain reports to determine whether the grantees have performed the activities that the grants are intended to finance? See Reg. 53.4945-4(c)(2), (3), and (5).
8. Will the foundation investigate any possible misuse of funds, withhold further funds during the investigation if a misuse of funds is discovered, seek recovery of misused funds, and insure the dedication of remaining funds held by the grantee to the purposes being financed by the grant? See Reg. 53.4945-4(c)(4).

Finally, it must be determined whether there is a limitation on the class of eligible grantees to bring the program under the employer-related scholarship or

educational loan provisions of Rev. Procs. 76-47 or 80-39. (See section 7 of this article for an explanation of what constitutes an "employer-related program.") Following is a list of possible developmental questions once an employer-related grant program is identified. The questions are geared toward determining whether the guidelines of the above-referenced revenue procedures are satisfied.

1. Describe the nature of the employer's business.
2. Describe the purpose of the grant(s) and any limitations put thereon.
3. Describe any limitations on the class of eligible grantees.
4. Will there be any requirement that grant recipients or their relatives become or remain employed with the employer in order to retain or renew their grant? If so, discuss.
5. Do you plan to publicize the existence of your grant-making program? If so, how and to whom? Furnish copies of any material you will distribute concerning your program.
6. Will potential grantees be required to submit an application? If so, furnish a copy.
7. Do you intend to make grants in the form of scholarships, loans, or both? If you will make loans, discuss their terms (rate of interest, repayment requirements, etc.). If available, furnish a copy of a loan agreement.
8. Identify by name the individuals who will select grant recipients, and indicate the past or present involvement of each (except for participation on the selection committee) with respect to the foundation, its organizer, and the employer concerned. (For example, ownership, employment, substantial contributor, disqualified person, etc.)
9. List the criteria or standards upon which the selection committee will base their choice of grant recipients.

10. Provide a statement as to whether, in each year of operation, the number of grants awarded to children of employees will not exceed:

(a) 25 percent of the number of employees' children who, (i) were eligible, (ii) were applicants for such grants, and (iii) were considered by the selection committee in selecting the recipients of grants in that year, or

(b) 10 percent of the number of employees' children who can be shown to be eligible for grants (whether or not they submitted an application) in that year.

If you propose that in any one year you will meet the 10 percent requirement, describe in detail how you will determine the number of eligible individuals.

11. Provide a statement as to whether, in each year of operation, the number of grants awarded to employees will not exceed 10 percent of the number of employees who, (i) were eligible, (ii) were applicants for such grants, and (iii) were considered by the selection committee in selecting the recipients of grants in that year.

12. If you do not propose to meet the percentage requirements set forth above, explain how your program meets the facts and circumstances test of section 4 of Rev. Proc. 76-47 (or section 4.02 of Rev. Proc. 80-39), a copy of which is enclosed for your convenience.

If it is concluded that additional information is needed to make a determination with respect to the organization's exempt status or grant-making program, the letter requesting the necessary information should advise the organization of its standing with respect to the 45-day rule of Reg. 53.4945-4(d)(3). If it is concluded that the IRC 4945(g) approval request was not properly submitted pursuant to Reg. 53.4945-4(d)(1), the organization should be advised that it can place no reliance on the 45-day rule. However, if it is concluded that the approval request was properly submitted, but that certain factual matters need clarification, the organization should be advised of when it can no longer rely on the 45-day rule should the information requested not be timely submitted. Whether

a request for IRC 4945(g) approval has been improperly submitted or is merely in need of clarification is a question to be determined on the basis of the facts and circumstances.

If it is concluded that the foundation qualifies for exemption under IRC 501(c)(3), but that IRC 4945(g) approval is not presently necessary, the determination letter should include the following warning:

To avoid the imposition of tax under section 4945(a) and (b) of the Code and possible termination under section 507(a)(2) of the Code, you should have your scholarship procedures approved pursuant to section 4945(g) prior to awarding any grants to individuals for travel, study, or similar purposes.

If it is concluded that the foundation qualifies for exemption under IRC 501(c)(3) and its grant-making program satisfies the requirements of IRC 4945(g), the following is representative of the approval paragraphs that should be included in the determination letter issued pursuant to IRM 7666.4:(3):

We have considered your grant-making procedures under section 4945(g) of the Code. Based on the information submitted and assuming your scholarship program will be conducted as proposed with a view to providing objectivity and nondiscrimination in the the awarding of grants, we have determined that your procedures in the awarding of scholarship grants comply with the requirements contained in section 4945(g)(1), and that scholarships granted in accordance with such procedures will not constitute "taxable expenditures" within the meaning of section 4945(d)(3). In addition, we have determined that grants made under your procedures are excludable from the gross income of recipients under section 117 of the Code.

This determination is conditioned on the understanding that there will be no material change in the facts upon which it is based. It is further conditioned on the premise that no grants will be awarded to the trust's creators, trustees, or members of the selection committee,

or for a purpose that is inconsistent with the purposes described in section 170(c)(2)(B) of the Code.

The approval of your grant-making procedures herein constitutes a one-time approval of your system of standards and procedures designed to result in grants which meet the requirements of section 4945(g)(1) of the Code. Thus, approval shall apply to subsequent grant programs only as long as the standards and procedures under which they are conducted do not differ materially from those described in your request.

Any funds you distribute to individuals must be made on a true charitable basis in furtherance of the purposes for which you are organized. Therefore, you should maintain adequate records and case histories so that any or all grant distributions can be substantiated upon request by the Internal Revenue Service.

If it is concluded that the foundation's grant-making program does not satisfy the requirements of IRC 4945(g), an adverse determination should be prepared in accordance with applicable provisions of IRM 7669.1:(1). However, see IRM 7666.31:(4) and section 10 of this article for certain exceptions.

A determination under IRC 4945(g) that is made in conjunction with a determination of the foundation's exempt status under IRC 501(c) is subject to IRC 6104 and, therefore, is not subject to IRC 6110 disclosure requirements. See IRC 6110(k)(1). See also clause 1 of section 7.08 of Rev. Proc. 83-36, 1983-1 C.B. 763; Chapter (49)42:(1) of IRM 7751, Exempt Organizations Handbook; and pages 566-570 of the 1979 ATRI.

It should be noted that grants to individuals which satisfy the requirements of IRC 4945(g) may result in the imposition of tax under other provisions of Chapter 42. See Reg. 53.4945-4(a)(1). See also pages 164-169 of the 1983 CPE.

9. Processing IRC 4945(g) Approval Requests Subject to IRC 6110

When a private foundation requests advance approval of its grant-making procedures, but not in conjunction with an exemption application, the same general approach as described in section 8 of this article should be taken in determining

whether the grant program is subject to, and satisfies the requirements of IRC 4945(g).

A request for a determination under IRC 4945(g) is subject to public disclosure pursuant to IRC 6110(a). See Chapter (49)42:(2) of IRM 7751. Each written determination subject to IRC 6110 must contain a complete statement of the pertinent facts, the applicable principles of law, and the rationale for the conclusions reached. However, IRC 6110(c) requires that certain information be deleted from the letter. See Chapter (49)45 of IRM 7751. The resulting letter, after the required deletions are made, is often referred to as a "sanitized" letter. Therefore, if the foundation's approval request does not include necessary statements with respect to IRC 6110 matters (see sections 7.09 and 7.10 of Rev. Proc. 83-36, 1983-1 C.B. 763), the foundation should be notified in writing of the problem, and allowed 30 days to provide the required representations or proposed deletions. If any additional information is needed to make the IRC 4945(g) determination, such information should also be requested in that letter. There should also be some reference to advise the foundation of its standing with respect to the 45-day rule of Reg. 53.4945-4(d)(3). If it is concluded that the IRC 4945(g) approval request was not properly submitted pursuant to Reg. 53.4945-4(d)(1), the foundation should be advised that it can place no reliance on the 45-day rule. However, if it is concluded that the approval request was properly submitted, but that certain factual matters need clarification, the foundation should be advised of when it can no longer rely on the 45-day rule should the requested information not be timely submitted. As previously indicated, the question of whether a request for IRC 4945(g) approval has been improperly submitted or is merely in need of clarification is determined on the basis of the facts and circumstances in each case.

To facilitate the deletion process and readability of the "sanitized" letter, alphabet letters should be used in the text of the determination in lieu of names and numbers wherever possible. Generally, capital letters "A", "B", "C", etc., should be used for the names of individuals, and "M", "N", "X", "Y", and "Z" for the names of corporations, places, and businesses. Lower case letters "x" and "y" should be used to represent certain numbers and, when used with the word "dollars," to represent sums of money. A legend identifying the named parties, numbers, etc., will be inserted on the first page of the determination letter. However, in most cases, the careful selection of wording will allow the letter to satisfy IRC 6110(c) requirements without the use of a legend, further enhancing the readability of the letter. Incorporation by reference of documents and facts in the text of the letter should be avoided, because referenced items would become available for public

inspection. Letters subject to IRC 6110 should always include the following paragraph near the closing of the letter:

This determination is directed only to the organization that requested it. Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.

The Exempt Organizations Current Developments Publications (Document 6606) list recent private letter rulings that have been released to the public pursuant to IRC 6110. Although such letters should not be used or cited as precedent, they would serve as examples of the format that is appropriate in the preparation of such letters. The text of private letter rulings is accessible through LEXIS and Commerce Clearing House materials. The following hypothetical rulings exemplify the above discussion:

* * * * *

LEGEND:

x = 5,000

M = Employer Company

N = New York City

Y = Scholarship Administrators, Inc.

Dear Sir or Madam:

We have considered your request for advance approval of your grant-making procedures under section 4945(g) of the Internal Revenue Code. Your request is considered to have been properly submitted on January 1, 1984, for purposes of section 53.4945-4(d)(3) of the Foundation Excise Tax Regulations.

Our records indicate that you are a trust recognized as exempt under section 501(c)(3) of the Code and are classified as a private foundation as defined in section 509(a).

The information submitted indicates that you will annually award one or more scholarship grants of x dollars per year to children of employees of M who reside in N. The scholarships will be renewable for up to three years, or until the attainment of a Bachelor's degree or the equivalent, whichever occurs first.

Your scholarship program will be administered by Y, an organization which administers a number of college scholarship programs and is completely independent of M. The selection committee will be composed of university representatives chosen by Y. You have represented that members of the selection committee will not benefit directly or indirectly if certain grantees are chosen over others, and that no grants will be made to disqualified persons within the meaning of section 4946(a)(1) of the Code.

To be eligible, grant applicants must have previously maintained an average grade of 70 percent or higher. Grant recipients will be selected on the basis of academic transcripts and the results of any achievement or aptitude tests taken. The recipient may select any course of study at any accredited college or university. The scholarship program will not be used by M to recruit employees or to induce employees to continue their employment. There will be no loss of scholarship funds because the recipients' parent terminates employment with M subsequent to the awarding of the scholarship.

You will pay the grants to Y, which will distribute the funds to the appropriate school on your behalf. If a student drops out of school during any given year, recoverable sums are returned and are not paid to the student. At the end of each academic year the student's transcript will be sent to Y in order that it can be determined if the scholarship should be renewed.

You have represented that the availability of the scholarship awards will be publicly announced. In addition, you indicated that in each year the 25 percent test of section 4.08 of Rev. Proc. 76-47, 1976-2 C.B. 670, will be met.

Section 4945(a) and (b) of the Code impose certain excise taxes on "taxable expenditures" made by a private foundation.

Section 4945(d)(3) of the Code provides that the term "taxable expenditure" means any amount paid or incurred by a private foundation as a grant to an individual for travel, study, or other similar purposes by such individual, unless such grant satisfies the requirements of subsection (g).

Section 4945(g)(1) of the Code provides that section 4945(d)(3) shall not apply to individual grants awarded on an objective and non-discriminatory basis pursuant to a procedure approved in advance, and the grants are scholarship or fellowship grants which are subject to the provisions of section 117(a) of the Code

and are used for study at an educational organization described in section 170(b)(1)(A)(ii) of the Code.

Section 53.4945-4(c)(1) of the regulations provides that to secure approval of a grant-making procedure a private foundation must demonstrate that:

- (a) The grant procedure includes an objective and nondiscriminatory selection process;
- (b) The procedure is designed to result in the performance of the activities intended to be financed; and
- (c) The foundation will obtain reports to determine whether the grant funds are being properly used.

Rev. Proc. 76-47, 1976-2 C.B. 670, sets forth guidelines to be used in determining whether a grant made by a private foundation under an employer-related grant program is a scholarship or fellowship grant subject to the provisions of section 117(a) of the Code. If a foundation's program satisfies the seven conditions set forth in sections 4.01 through 4.07, and meets the percentage test described in section 4.08, the Service will assume the grants awarded under the program will be scholarships or fellowship grants subject to the provisions of section 117(a).

Based upon the information submitted and the representations made therein, we conclude that your grant program satisfies the guidelines of Rev. Proc. 76-47, 1976-2 C.B. 670. You have represented that the number of scholarships that you will award to children of employees of M in any year will not exceed 25 percent of the number of employees' children who, (i) were eligible, (ii) were applicants for such grants, and (iii) were considered by the selection committee in selecting the recipients of grants in that year. Accordingly, your scholarship grants will be subject to section 117(a) of the Code and are, thereby, the type of grant described in section 4945(g)(1) of the Code. In addition, we conclude that your procedures satisfy the requirements of section 53.4945-4(c)(1) of the regulations.

Therefore, assuming that your scholarship program will be conducted as proposed, with a view to providing objectivity and nondiscrimination in the awarding of grants, we have determined that your procedures in the awarding of scholarship grants comply with the requirements of section 4945(g)(1) of the Code, and that scholarships granted in accordance with such procedures will not

constitute "taxable expenditures" within the meaning of section 4945(d)(3). In addition, we have determined that grants made under your procedures are excludable from the gross income of recipients under section 117 of the Code.

This determination is conditioned on the understanding that there will be no material change in the facts upon which it is based. It is further conditioned on the premise that no grants will be awarded to the trust's creators, trustees, or members of the selection committee, or for a purpose that is inconsistent with the purposes described in section 170(c)(2)(B) of the Code.

The approval of your grant-making procedures herein constitutes a one-time approval of your system of standards and procedures designed to result in grants which meet the requirements of section 4945(g)(1) of the Code. Thus, approval shall apply to subsequent grant programs only as long as the standards and procedures under which they are conducted do not differ materially from those described in your request.

Any funds you distribute to individuals must be made on a true charitable basis in furtherance of the purposes for which you are organized. Therefore, you should maintain adequate records and case histories so that any or all grant distributions can be substantiated upon request by the Internal Revenue Service.

This determination is directed only to the organization that requested it. Section 6110(j)(3) of the Internal Revenue Code provides that it may not be used or cited as precedent.

You must report any future changes in your grant-making procedures. Please keep a copy of this letter in your permanent records.

* * * * *

Dear Sir or Madam:

This is in response to your letter of January 1, 1984, wherein you requested advance approval of your grant-making procedures under section 4945(g) of the Internal Revenue Code.

The information submitted indicates that you are a trust described in section 4947(a)(1) of the Code and subject to taxes imposed under section 4945 of the Code.

You intend to award scholarships of varying amounts (depending on the availability of funds) to an unspecified number of graduating seniors at a particular high school. To be eligible for consideration, an individual must submit evidence of acceptance into an accredited college or university, and complete an application form that includes the following information: (i) past academic performance, (ii) results of tests designed to measure ability and aptitude for college work, (iii) recommendations from instructors, and (iv) financial circumstances of the applicant and his/her immediate family. Publicity regarding your grants, and copies of the required application form are available at the high school.

Grant recipients will be selected by a selection committee consisting of your sole trustee, the principal of the high school, and the minister of a particular church. Recipients will be selected on the basis of academic achievement and financial need. In no event will a "disqualified person" with respect to you be eligible for a grant.

Scholarship funds will be paid directly to the school in which the recipient is enrolled. The school will defray the expenses as they come due only if the recipient continues to be enrolled in good standing. In addition, the school will furnish a report of the recipient's grades at least once a year. In the event a recipient withdraws from school during an academic period, grant amounts advanced for expenses for that period will be regarded as interest-free loans to be repaid to the trust. You will take appropriate steps to recover unused grant funds or amounts treated as loans. You will retain records regarding all grants you will award.

Sections 4945(a) and (b) of the Code impose certain excise taxes on expenditures defined as taxable expenditures by section 4945(d). Section 4945(d)(3) includes in the definition of taxable expenditures any amount paid or incurred by a private foundation as a grant to an individual for travel, study, or similar purposes by such individual, unless such grant satisfies the requirements of section 4945(g).

Section 4945(g) of the Code provides that section 4945(d)(3) shall not apply to individual grants awarded on an objective and nondiscriminatory basis pursuant to a procedure approved in advance if it is demonstrated that:

1. The grant constitutes a scholarship or fellowship which is subject to the provisions of section 117(a) and is to be used for study at an educational organization described in section 170(b)(1)(A)(ii);

2. The grant constitutes a prize or award which is subject to the provisions of section 74(b), if the recipient of such prize or award is selected from the general public; or
3. The purpose of the grant is to achieve a specific objective, produce a report or similar product, or improve or enhance a literary, artistic, musical, scientific, teaching, or other similar capacity, skill, or talent of the grantee.

Section 53.4945-4(c)(1) of the Foundation Excise Tax Regulations provides that to secure approval of a grant-making procedure a private foundation must demonstrate that:

- a. The grant procedure includes an objective and nondiscriminatory selection process;
- b. The procedure is designed to result in the performance of the activities intended to be financed; and,
- c. The foundation will obtain reports to determine whether the grant funds are being properly used.

Your grant-making procedures, as described, satisfy the requirements of section 53.4945-4(c)(1) of the regulations. Your selection committee will not be in a position to derive a private benefit, directly or indirectly, if certain potential grantees are selected over others. The group from which you will select grantees is sufficiently large to constitute a charitable class, and your criteria for selection are reasonably related to the purpose of your grants. By making the scholarship funds available to the recipient through the educational institution, you are assuring that the funds will be used for proper purposes.

Therefore, assuming that your scholarship program will be conducted as proposed, with a view to providing objectivity and nondiscrimination in the awarding of grants, we have determined that your procedures in the awarding of scholarship grants comply with the requirements of section 4945(g)(1) of the Code, and that scholarships granted in accordance with such procedures will not constitute "taxable expenditures" within the meaning of section 4945(d)(3). In addition, we have determined that grants made under your procedures are excludable from the gross income of recipients under section 117 of the Code.

This determination is conditioned on the understanding that there will be no material change in the facts upon which it is based. It is further conditioned on the premise that no grants will be awarded to the trust's creators, trustees, or members of the selection committee, or for a purpose that is inconsistent with the purposes described in section 170(c)(2)(B) of the Code.

The approval of your grant-making procedures herein constitutes a one-time approval of your system of standards and procedures designed to result in grants which meet the requirements of section 4945(g)(1) of the Code. Thus, approval shall apply to subsequent grant programs only as long as the standards and procedures under which they are conducted do not differ materially from those described in your request.

Any funds you distribute to individuals must be made on a true charitable basis in furtherance of the purposes for which you are organized. Therefore, you should maintain adequate records and case histories so that any or all grant distributions can be substantiated upon request by the Internal Revenue Service.

This determination is directed only to the organization that requested it. Section 6110(j)(3) of the Internal Revenue Code provides that it may not be used or cited as precedent.

You must report any future changes in your grant-making procedures. Please keep a copy of this letter in your permanent records.

* * * * *

IRC 6110(d) requires that the Service note on every determination open to public inspection the receipt of any third-party communication (written or otherwise) concerning such determination. See Chapter (49)46 of IRM 7751. Therefore, a written record of all third-party communications must be made. Form M-6535, Memorandum of Contact, has been developed for this purpose. See IRM (11)000, Exhibit (11)100-16.

10. National Office Issues

Exemption applications involving IRC 4945(g) approval should be referred to the National Office pursuant to IRM 7664.1 only if the question of IRC 501(c)(3) qualification cannot be determined on the basis of published precedent.

However, if it is concluded that the foundation qualifies for exemption under IRC 501(c)(3), but there are questions regarding the approval of the foundation's grant-making procedures that cannot be resolved on the basis of published precedent, technical advice should be requested of the National Office in accordance with the procedures set forth in Rev. Proc. 80-26, 1980-1 C.B. 671. An example of such a question is a scholarship program that discriminates on the basis of ethnic origin. See pages 205-208 of the 1982 CPE and pages 154-156 of the 1983 CPE. In addition, technical advice should be requested in cases involving employer-related scholarships under Rev. Proc. 76-47, 1976-2 C.B. 670, (or employer-related loans under Rev. Proc. 80-39, 1980-2 C.B. 772) in the following instances:

- (1) The case involves the "facts and circumstances test" under section 4 of Rev. Proc. 76-47.
- (2) An adverse determination is indicated.
- (3) A favorable determination is indicated, but the organization does not clearly meet the requirements of Rev. Proc. 76-47.

Also, if any of the issues mentioned above arises in a request for advance approval under IRC 4945(g), technical advice should be requested of the National Office. See IRM 7666.31:(4).

A specific concern that has been expressed in this area is the question of whether a foundation receiving approval of its grant-making procedures after January 1, 1970, and prior to October 30, 1972 (the date final regulations were published), has to reapply for approval of its procedures even though there have been no changes in its procedures for grants made after October 30, 1972. The apparent answer would seem to be that the original approval should be sufficient if: (1) the approval was issued under the signature of the Director, Miscellaneous and Special Provisions Tax Division, and (2) the program is not employer-related (see Rev. Proc. 77-32, 1977-2 C.B. 541). However, due to the uncertainty of this issue, National Office consideration would be warranted. The applicability of IRC 7805(b) relief should be considered in such cases.

11. Operational Developments

When the examination of Form 990-PF, Return of Private Foundation, discloses that a private foundation has a grant-making program for which it has not applied for advance approval under IRC 4945(g), the examining agent will, with

the exception of the issues mentioned in section 10 of this article, make the determination as to whether the program meets the requirements of IRC 4945(g). The discussion in section 9 of this article is applicable in such situations. See IRM 7(10)66.5.

The determination whether the foundation's grant-making procedures meet the requirements of IRC 4945(g) will be made for purposes of correction as described in Reg. 53.4945-1(d)(1). However, it should be noted that the foundation will still be liable for the initial tax imposed under IRC 4945(a)(1). See IRM 7(10)66.51:(5). See also German Society of Maryland, Inc. v. Commissioner, Docket No. 3512-80, T.C. No. 35, 4/21/83, wherein the court held that correction by getting retroactive approval of the exact procedures did not relieve the private foundation of the first-tier tax of IRC 4945(a)(1), only of the additional tax of IRC 4945(b)(1).